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December 19, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

Re: CC Docket No. 96-45

Dear Mr. Caton:

Transmitted herewith, on behalf of TDS Telecommunications Corporation (TDS Telecom) and Century Telephone Enterprises, Inc. (Century) are an original and 9 copies of their comments in response to the Commission's November 18, 1996 Public Notice inviting comment on the Joint Board's Recommended Decision, CC Docket No. 96-45 (adopted November 7, 1996).

In the event of any questions concerning this matter, please communicate with this office.

Very truly yours,

Margot Smiley Humphrey
Margot Smiley Humphrey

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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DEC 19 1996

Federal Communications Commission
Office of Secretary

In the Matter of

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Federal-State Joint Board on
Universal Service

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CC Docket No. 96-45

COMMENTS OF TDS TELECOM AND CENTURY TELEPHONE ENTERPRISES, INC.

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December 19, 1996

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of)	
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Federal-State Joint Board on)	CC Docket No. 96-45
Universal Service)	

COMMENTS OF TDS TELECOM AND CENTURY TELEPHONE ENTERPRISES, INC.

TDS Telecommunications Corporation (TDS Telecom or TDS) and Century Telephone Enterprises, Inc. (Century), by their attorneys, submit these comments on the Recommended Decision of the Joint Board in the above-captioned proceeding,¹ in response to the Common Carrier Bureau's November 18, 1996 request (DA 96 1891) (Request). TDS Telecom and Century own 105 and 36 small and primarily rural incumbent local exchange carriers (ILECs), respectively, in a combined total of 32 states. Each of these xxx [combined] ILECs fits the 1996 Act's definition of a "rural telephone company" (RLEC) (47 U.S.C. §153). (47)).² TDS and Century have been active participants in this proceeding on behalf of their RLECs.

¹Federal -State Joint Board on Universal Service, CC Docket No. 96-45, FCC 96J-3 (released Nov. 8, 1996) (Recommendation).

²Pub. L. No. 104-104, 110 Stat. 56. Citations herein will be to the Communications Act of 1934, as amended by the 1996 Act and codified at 47 U.S.C. §§151 et seq. ("the Act") or to the "1996 Act."

Their continuing participation reflects the importance of existing, past and future high cost compensation programs to the ability to provide their rural customers high quality, evolving telecommunications services and access to advanced services and network capabilities.

I. INTRODUCTION AND SUMMARY

TDS and Century commend the Joint Board for the progress made thus far under strict statutory deadlines for implementing universal service under section 254 of the 1996 Act. While there is much in the Recommendation that should benefit rural customers, many of the crucial decisions that will shape rural service and stimulate or deter rural infrastructure development remain for decision in this second phase -- and a third phase on proxies for RLECs. Moreover, the press of time, the enormity of the Joint Board's task and some misapplied concepts have led to several recommendations which will require significant modification to achieve the goals and principles Congress enacted. We are pleased that the states will have a continuing role in developing high cost mechanisms along with this Commission. TDS and Century plan to be involved in the upcoming workshops seeking to find lawful and effective ways to implement the redefined universal service mandate enacted in the 1996 Act.

SUMMARY

TDS and Century commend the Joint Board on its progress on these complex universal service issues and will participate in the further efforts to develop a proxy that is sufficient under the 1996 Act and reliably able to predict relevant high rural telephone costs. At the same time, there remain serious legal and constitutional issues about the use of forward looking costs or a

hypothetical and idealized future network to measure real world costs. These remain even as the proceeding looks to particular proxy issues. We are pleased that the states will continue to play a role and that further proceedings are acknowledged necessary to craft a suitable proxy for rural LECs. We suggest the following rural concerns, universal service support criteria and modifications in the Joint Board approach:

The universal service mechanisms must meet the dual statutory mandate for equitable and non-discriminatory carrier contributions and “explicit” support. An end user surcharge to recover contribution responsibilities apportioned equitably and non-discriminatorily on interstate providers is lawful and best-suited to meeting the two-part Congressional collection mandate. Once the federal fund size is determined by an appropriate cost identification and benchmark mechanisms, the process for apportioning carrier contributions must be economically sound and fair. The recommended method of apportionment among carriers mixes two economic approaches and fails to achieve the fairness and efficiencies of the “value added” proposal the Joint Board intended. A value added levy must be collected either (a) on gross receipts for final goods and services only or (b) on payments for intermediate as well as final goods and services, net of intermediate payments, including the levy component of those payments. It is not competitively neutral to mix the two, as the Recommendation does, and apply a levy to gross revenues net of payments to other carriers but not collect the levy on those sales to other carriers. A final collection plan must remedy this discrimination against ILECs and their end users. The unfairness falls most heavily on rural LECs and their subscribers. An end user surcharge is a better method already subject to new contribution responsibilities, which the Joint Board has not

accounted for in its costing and revenue benchmarking scheme. These universal service providers have the least flexibility to recover revenue shortfalls caused by inappropriate mechanisms at any stage of the process. The Commission should also specify that universal service support is not part of the gross revenues used to assign contribution shares, since the Act restricts that to actual spending for universal service.

The proxy search should be expressly directed to satisfying the Act's requirements for sufficient, predictable, specific federal support to achieve the Act's universal service purposes, including "just, reasonable and affordable rates," "reasonably comparable" rural and urban rates and services and nationwide access to advanced and information services. All components of the high cost mechanisms must accommodate unique rural service conditions and the great variances among rural LECs. Proxy models must be validated and proved as real world cost predictors able to satisfy the above-noted statutory standards. Assumptions about efficiency in rural markets cannot simply be equated with presumed urban market facts.

Comments and facts should be allowed on a specific proposal that parties are able to evaluate, price out and test under the statutory principles and standards. A good example of why this is essential is the Joint Board's erroneous treatment of second residential lines and multiple business connections. Eliminating support for these lines will be an administrative nightmare, and will not effect substantial fund "savings," since most of the costs of high cost loops are incurred to install the first line. And the law does not authorize regulatory judgments about what lines or customers should be deprived of the Act's unqualified commitment to "reasonably comparable" rural and urban rates and services. The error is important because the loss of per line

support assumes that the costs and support for all lines are equal when the lost support actually exceeds the minimal cost savings from providing added lines at their low incremental cost. Per line support portability causes the same dilemma and can only aggravate the unreasonable proposal to make transitional frozen support “portable” even if the new recipient carrier is acquiring the underlying carrier’s lines for incremental or subsidized prices and pricing them to reap a double profit. Costs, revenues and support per-customer are the proper measures in the new regulatory and competitive era.

The backward looking historical revenues benchmark is improperly compared to forward looking costs, without adjustment for regulatory changes already underway, pricing adjustments new contribution burdens, rural market demand, customer base and service differences or competition’s effects. Indeed, the notion that LEC revenues measure customer payments on a nationwide comparable basis is wrong. Unlike urban subscribers, whose local rates include service to large areas, rural subscribers have to pay toll bills to their interexchange providers to reach their “community of interest”-- additional expenditures which are ignored by assuming the LEC’s local, access and discretionary revenues can stand in for a comparison of whether customers are shouldering the same minimum responsibility for the costs of their service. Creating two benchmarks, based on novel line and customer distinctions, will cause administrative costs and data collection burdens, to the extent that the classification can be implemented at all. For example, NECA pool members have no way to determine their access revenues by first primary residence lines or single line business connections. Rate and cost benchmarks should be reconsidered unless these problems with the revenues benchmark can be

rectified.

Bifurcated treatment for rural LECs is wise, but freezing historical support will deter investment, ignore most investment between 1995 and at least the end of the transition and violate the sufficient support requirement. Improper line eligibility and per-line rather than per customer support measures also threaten the abrupt shortfalls the transition is meant to avoid. Rural LECs also need a simple zone, density or even proxy factor apportionment method to target support within their study areas and prevent windfalls and distorted entry signals for “competitors.” The plan should allow for exogenous cost adjustment and a reasonable investment growth rate suited to an advancing infrastructure and the universal service principles. Finally, competitive bidding in rural areas will infringe on states’ authority over additional support-eligible carriers and withdrawal from eligibility and provide inadequate support for any losing bidder, contrary to the Act. The Commission should not waste time and resources to pursue this issue now.

II. UNIVERSAL SERVICE CONTRIBUTIONS MUST BE EQUITABLY IMPOSED ON CARRIERS AND LAWFULLY RECOVERED FROM CUSTOMERS.

A. Contributions Should Be Recovered Through a Uniform Nationwide Surcharge on Customer Bills

The Recommendation correctly observes (§ 802) that the Act requires an “equitable and nondiscriminatory contribution” from every provider of “interstate telecommunications services.” It goes on to reason incorrectly that its proposal must set contributions only for carriers, on the theory (§ 812) that recovery through the SLC or a retail-user surcharge “would violate the statutory requirement that carriers, not consumers, finance support mechanisms.”

Instead, the Joint Board anticipated (§808) that the carrier contributions would be

recovered implicitly in charges to “users.”³ However, this interpretation conflicts with the Act’s equally direct requirement in section 254 for universal service support that is “explicit and predictable.” For example, if contributions are left for the contributing carriers to recover in some way from customers, it is unclear where the contribution will be charged for recovery. The legislation does not give the Joint Board discretion to select which of these statutory policies to implement and which to disregard. To satisfy the statute, both the equitable carrier contribution and the explicit support mandates must be implemented.

Since contributors must be allowed to recoup their contributions from their customers to avoid an unconstitutional “taking” and the Recommendation would forbid carriers from recovering support from unbundled network elements (§ 808), the Joint Board’s failure to require explicit recovery from contributing carriers’ customers leaves contributing carriers with the incentive -- possibly their only choice -- to recoup their universal service contributions in the rates of their least elastic end user customers. And that assumes that they have the flexibility to do so, which, in most cases they do not. It is not reasonable to conclude that a statutory provision expressly requiring “explicit” recovery of universal service support somehow compels a mechanism through which end users pay charges containing undisclosed universal service support.⁴ Congress’s wish for full disclosure and accountability cannot have been confined to protecting knowledgeable carriers, while condoning -- or even requiring --

⁴See, Separate Statement of Commissioner Schoenfelder, p.7 (Nov. 7, 1996) (“Customers are entitled to be made aware of the charges they are paying to support the recommendations made herein.”)

“implicit” recovery from unsuspecting consumers.

The purpose of requiring carrier contributions to meet the stated standards was to spread over all carriers the duty to contribute that previously applied only to the interexchange carriers (through access charges and the current Universal Service Fund) and certain large LECs (through Long Term Support) and these carriers’ end users (through their rates). The rationale is that imposing a further requirement for the recovery of each carrier’s equitable and nondiscriminatory universal service contribution from its end user customers by passing through the same uniform nationwide percentage charge based on revenues pro rata to its end user (retail) customers would conflict with the initial requirement to assess nondiscriminatory carrier contributions. This reasoning is specious. Such a two-level recovery is, in fact, the best way to give force to both the “nondiscriminatory” carrier contribution requirement and the “explicit” support mandate. A uniform charge and uniform pass through would also avoid indirectly replicating the steep rural cost burden of SLC increases,⁵ an outcome which the Joint Board rejected (§ 769).

B. Allocating Carrier Contributions Based on Gross Revenues Net of Payments to Other Carriers Shifts an Inequitable and Discriminatory Burden onto LECs.

The Joint Board recommends (§ 807) allocating the responsibility for contributions to fund the “sufficient” support fund, “sized” by its cost and benchmark formula, from carriers based on their gross revenues less payments to other carriers. Without carefully analyzing the impact on various contributors and their customers, the Recommendation pronounces its

⁵SLC increases are not averaged because each ILEC charges no more in SLCs than its own cost.

proposal "competitively neutral." Unfortunately, the Joint Board has mixed two approaches, each of which would have been sound alone, and has come up with a proposal that causes the asymmetry and resulting competitive imbalance the Joint Board set out to avoid. The use of a value-added levy or tax to ensure competitive neutrality is typically accomplished in one of two ways: (1) The levy is collected on gross receipts for final goods and services only, or (2) the levy is collected on payments for intermediate as well as final goods and services with the levy calculated on gross receipts net of payments for intermediate goods and services, including the levy component of those payments. The Joint Board's recommendation that the levy be applied to gross revenues net of payments to other carriers but that the levy not be collected on sales to other carriers mixes the two standard approaches and, as a consequence, introduces competitive asymmetries that otherwise would not arise. It has not achieved the value added fairness and efficiencies it intends (¶807), since it has denied the ILEC the ability to pass through a fair share of the ILEC's contribution to its carrier-customers. Instead of allowing pass through, the proposal denies the underlying carrier the right to recover its universal service contribution if its carrier-customer purchases unbundled elements.⁶ But the Joint Board's effort to prevent distortions on intermediate product markets by allowing carriers to deduct payments to other

⁶See ¶ 808. This paragraph seems to say that ILECs may not recover for their universal service contributions in their charges to other carriers for unbundled elements, but may recover a portion of their universal service contributions in their charges to "users" of unbundled elements. The meaning is not clear. It appears to mean that ILECs may not include any contribution recovery from interexchange carriers that use unbundled elements in charges to the carriers. They cannot recover from the "end users" of those elements because they are customers of the interexchange carriers. The Commission should clarify how these Joint Board statements can prevent unfairness and discrimination against the ILECs and their non-carrier customers.

carriers from their gross revenues used to allocate carrier contributions also disadvantages the underlying carrier. To achieve equitable and efficient recovery of the universal service support however, it would be necessary to levy for universal service support through charges at the retail level.

The hybrid plan provides non-facilities-based competitors a way to concentrate the recovery obligation on the facilities-based ILEC. Consider a CLEC that provides transport and switching, but resells the ILEC's loops to provide service. It can deduct its payments for the unbundled loops from its gross revenues and reduce the base on which its share of the responsibility for funding federal high cost support. In contrast, the facilities based ILEC that uses its own loops can neither deduct its loop costs from its gross revenue figure nor pass the contribution through to the competing partial reseller or to its retail customers. Although the ILEC could simulate the CLEC's situation by creating a separate affiliate that would resell its own loops, that incentive could add costs and diminish its efficiency without serving any legitimate purpose. The inequitable burden on a facilities-based carrier would also distort the competitor's decision whether to build facilities.

The adverse impact will be particularly acute for high cost RLECs. These carriers of last resort now receive high cost compensation and "pay" by providing low cost universal service and remaining subject to common carrier regulation as carriers of last resort. In most cases, their asymmetrical regulation includes pricing constraints on both local and interexchange access rates. Although the lion's share of the obligation to contribute for the costs of universal service and recover those contributions from retail customers will shift to

ILECs under the Joint Board plan, they have the least flexibility to recover their contribution. The interexchange carriers will be relieved of their burden as today's principal contributors. AT&T, MCI and Sprint, subject to very few restraints on how they recover their costs, have recently raised their rates.⁷ The large urban-centered LECs will also be relieved of the Long Term Support obligation that until now has applied only to them. Thus, the RLECs are the only group the Joint Board plan gives nothing positive to counterbalance their heavy new support obligations.

1. RLECs May Have No Means to Recover Steep New Contributions.

There is no reason to believe that state regulators will let RLECs raise their local rates to fund the large new burden that will fall on them, especially when RLECs will also lose support on their second residential lines and multiline business connections. RLECs will likely absorb even more of today's interexchange carrier contribution because their access customers will be free to bypass them or take unbundled elements under section 251, free from implicit contribution recovery (§ 808). Further, it is too early to speculate on what the upcoming access charge proceeding will do to RLECs' access revenues. The claim that requiring contribution based on end user (*i.e.* retail) revenues would spare wholesale carriers from "direct" contributions cannot outweigh the competitive disadvantage of loading contribution burdens on LECs, while allowing interexchange carriers and resellers to avoid direct or indirect payment of contributions by taking unbundled elements under section 251(c). The express

⁷See, Communications Daily, "AT&T Raises Rates 5.9% on Residential Long Distance, MCI 4.9%," pp. 1-2 (Friday, November 29, 1996). See also, Telecommunications Reports, "Bell Atlantic Slams IXC's 'Grinch-like' Rate Hikes, p. 15 (December 9, 1996).

requirement of the Act for equitable and nondiscriminatory carrier contributions and explicit support must take precedence over the Joint Board's incorrect application of "value added" theory, which is not accompanied by the essential pricing flexibility and even-handed regulation for ILECs. Absent ILEC ability to recover flexibly, the value added approach merely maximizes the contribution and cost recovery burden and creates a competitive disadvantage for ILECs. ILECs are already saddled with universal service responsibilities and regulatory burdens far more onerous than those applied to their competitors or their carrier customers. The Commission should take a course with more even-handed competitive impact, such as apportioning contribution responsibilities based on end user revenues and having carriers pass them through to their end user customers or at least enabling the ILECs to recover their costs in their charges to other carriers, as well as from their end users.

2. The Commission Should Not Encourage Universal Service Cost Recovery from Customers Without Alternatives.

If the Commission follows the Joint Board's "value added" contribution assessment proposal — loading the contribution burden on LECs by allowing other carriers both to deduct carrier payments and to avoid absorbing the ILECs' contribution in what they pay to use the ILECs' networks — the Commission should mitigate the unmistakable LEC disadvantage and fairly distribute the burden of recovery on all end users. If that's done, ILEC retail customers need not absorb the greatest share of the contributions to support universal service. Unless the Commission adopts the end user surcharge discussed above, it must at least achieve "explicit" recovery from the carrier-customers, as the statute requires. It must design a recovery mechanism to draw a nondiscriminatory and equitable payment from the carriers that use the

ILECs' networks and their customers without burying the support in the access or other rates charged to the carrier-customers. Implicit support of just that sort is what led Congress to require "explicit" support in the first place. The Commission can achieve all three objectives — spreading a fair share of universal service costs, requiring fair recovery from the ILECs' carrier customers and their end users and avoiding new implicit recovery — by (a) allowing all carriers to deduct their payments to other carriers and (b) allowing contributing carriers to pass their contributions through to their carrier - and retail customers on a nondiscriminatory and equitable basis.⁸

As noted above, unless the Recommendation is modified to prevent disproportionate recovery from ILEC end user customers, the Joint Board's plan will indirectly cause adverse customer impact that is equivalent to the SLC increases the Recommendation categorically rejects in paragraph 769. That result would conflict with the Act's principle and purpose of "just, reasonable and affordable" rates and "reasonably comparable" rural and urban rates and services.

B. Universal Service Support Should Not Be Included in the Revenues Used to Allocate the Federal Universal Service Fund Contributions Among Carriers.

The Commission should specify that universal service compensation will be excluded from gross revenues in allocating carrier contributions. The Recommendation is silent as to whether the Joint Board intends to include the universal service compensation identified by the

⁸Such a federal pass through requirement to fund the federal universal service mechanism would no more infringe states' local ratemaking role than did the Commission's recovery of interstate access charges directly from local customers via the Subscriber Line Charge (SLC). *NARUC v. FCC*, 737 F.2d 1095, 1115 (D.C. Cir. 1984).

proxy and benchmark formula in a carrier's "gross revenues" for purposes of equitably allocating the funding responsibility for federal universal service contributions among contributing telecommunications carriers. Logic compels the conclusion that universal service "support" -- calculated to make up a measured shortfall between the revenues each carrier is expected to collect from its customers and the costs determined by the proxy -- should be used only to offset that gap between proxy high costs and a nationwide customer payment expectation. Section 254(e) requires any support payment to be used "only for the provision, maintenance, and upgrading of facilities for which the support is intended." If that shortfall payment is "counted" so as to increase the share of the universal service fund paid by the provider of high cost rural service, and then recouped from the high cost area's end user customers, the recovery mechanism will (a) undercut the support the formula has found necessary (b) use it for an unlawful purpose and (c) burden the very end users the high cost mechanism is designed to benefit. The reiterative calculations would also add to the administrative complexity of the mechanism.

III. HIGH COST COMPENSATION CALCULATIONS MUST REFLECT IMPORTANT RURAL DIFFERENCES.

A. Lawful Application of Forward Looking Proxy Costs for Rural LECs Will Require Dramatic Improvements in the Models, Rigorous Validation, Individualized Price-Outs and Responsible Application of the Statutory Principles and Standards.

The record before the Joint Board conclusively demonstrated, and the Joint Board has acknowledged (§ 268), that no proxy suggested thus far is "sufficiently developed to allow us to recommend a specific model at this time." The Recommendation went on to conclude that

“the proposed proxy models’ designs do not reflect the special characteristics of these [rural] carriers” (§ 271). Because the Joint Board was aware (§ 271) that premature use of an insufficiently accurate proxy model could place “at risk” the “operations of some carriers,” it recommended (§ 272) a 3-year delay in implementing proxies for RLECs, after they take effect for other LECs, and a 3-year phase-in of any proxy model for RLECs.

Given the record compiled up to now, it was impossible to determine that use of a proxy would satisfy the Act’s universal service principles and standards, especially for RLECs.⁹ Nevertheless, the Joint Board decided (§ 272) to develop (via staff “workshops”) and apply a proxy to non-rural LECs by January 1, 1998, then to “tailor the model for rural companies,” to “review” the model “to ensure the appropriateness of the proxy model for rural carriers before requiring them to use a proxy model,” and to phase in the proxy model for RLECs by the end of 2004. TDS and Century endorse the decision that further proceedings are necessary before imposing a proxy on RLECs. However, the schedule for implementation must not shortchange the process or rush into a harmful proxy prescription.

In response to the Bureau’s Request (p.2) for “comments on the Commission’s legal authority to implement such recommendations,” TDS and Century urge the Commission to recognize:

(1) that the Recommendation does not even claim to evaluate or support the use of a

⁹See separate statements of Commissioner Chong, p. 2 (so far, no proxy “makes my heart sing”); Commissioner Schoenfelder, p. 1 (further review of proxy needed); and Commissioners Johnson and Nelson, p. 7 (cautious recommendation to adopt proxy models, “pending sufficient improvement to address outstanding concerns about accuracy. . . .”)

proxy under the universal service principles and standards of the Telecommunications Act of 1996 (§254), and

(2) that the Commission cannot lawfully implement a proxy model to identify costs for ILECs, and particularly for RLECs, unless and until it can conclude that using the selected proxy model in the particular proposed high cost compensation mechanism will

(a) provide “specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service,” ((§254(b)(5)),

(b) provide “sufficient... Federal support to ... achieve the purposes of this section” (§254 (e)),

(c) result in “quality services at just, reasonable and affordable rates,” (§254 (b)(1)), and

(d) support nationwide access to advanced telecommunications and information services, including “reasonably comparable” rural and urban rates and services (§254(b)(2)-(3)).

It would be wise for the Commission to build all of these statutory standards and principles explicitly into the workshop plans and its decision making process.¹⁰ Appendix F of the Recommendation and the Joint Board’s discussion of the process do not adequately reflect the statutory criteria. The Commission must be certain that it will obtain the information and

¹⁰In addition, as the Joint Board recognizes (§297), the Act requires that a recipient of federal support use that support solely to provide universal service and forbids cross-subsidy by ratepayers, which must logically preclude excess support from end users whose rates in part recover the carrier contributions required by §254(e) and windfall support payments to CLECs.

perform the tests necessary to conclude in good faith that the proxy model and compensation plan will comport with the universal service directives enacted by Congress.¹¹

TDS and Century remain skeptical about the possibility of crafting a forward-looking cost proxy able to pass muster for RLECs. There is ample evidence that economists differ on the issue.¹² But there is no point in belaboring arguments in these comments that have been made before and can be raised again if the chosen plan does not resolve the problems. Thus, regardless of their concerns, TDS and Century look forward to participating in good faith in the joint federal and state efforts to develop a proxy (or proxies) that meet all the applicable standards for all LECs, including RLECs.

TDS Telecom has tried to participate in industry efforts to combine elements of the proposed proxies into an improved model. However, TDS and Century and their LECs, like all but the biggest ILECs, lack the necessary data to have the impact on their LECs factored into the proxy models. For example, few RLECs have performed forward looking cost studies. RLECs also lack SCIS, TSLRIC and ARMIS data. Consequently, it may be quite difficult to obtain the kinds of data it will take to “tailor” and sufficiently “improve” a proxy to make it suitable for RLECs.

¹¹The experience with earlier Commission implementation decisions also indicates that the decision here may also ultimately need to satisfy judicial and constitutional scrutiny.

¹²E.g. Letter from Alfred E. Kahn, Wall Street Journal, Nov. 29, 1996 (Kahn letter), quoting and supporting letter from Professor John DiIulio and criticizing the TELRIC model for “promulgating prices the local exchange companies (LECs) must charge would-be competitors for access to their networks “ based on a hypothetical pricing scheme that only an armchair economist could love... almost completely ignor[ing] the actual costs that local companies incurred to create the system.”

1. A Proxy Model Must Account for RLEC Diversity.

Tailoring a lawful proxy model for RLECs will require taking into account the enormous variations in costs and characteristics for serving rural areas demonstrated in the record.¹³ The experience with proxy proposals so far demonstrates that the inputs into a model are of paramount importance. In all proposed models, changes in inputs and assumptions can make dramatic differences in the cost predictions. The persistent existence of extreme “outliers” in the proxy model results for RLECs suggests that fruitful inquiry must include (a) ways to individualize the inputs for such carriers and (b) an administratively simple waiver for instances when the model still lacks sufficient accuracy. Individual company inputs or adjustments to the study inputs appear necessary if a workable, lawful and constitutional model is to emerge. The proposed proxies, to date, have not even been validated as accurately predicting the forward looking efficient network costs they are designed to model. No network has been constructed or even designed for specific markets against which to test the accuracy of the models as predictors of the forward-looking costs of an optimally efficient network. Thus, the proposed proxies may not model what they purport to model, let alone the actual, real-world embedded costs which have been demonstrated to be required by law in the interconnection litigation.¹⁴ If the model cannot be tested in the real world design of individual

¹³E.g. Reply Comments of Century Telephone Enterprises, Inc. And TDS Telecommunications Corporation, Inc., pp. 1-7 (May 7, 1996); Letter of Elizabeth H. Valinoti to William F. Caton reporting ex parte meeting and attached information about shortcomings of proxy proposals in rural areas (October 18, 1996). See also National Exchange Carrier Association (NECA), Report on the BCM², cc Docket No. 96-45 (July 30, 1996).

¹⁴ CITE THE LARGE LECS’ BRIEF IN THE 8TH CIRCUIT.

networks and market facts, there is no way to establish the level of confidence necessary to rely on its cost predictions for a conclusion that will support the standards for high cost compensation that Congress enacted.

2. A Proxy Model Must Account for Rural Market Facts.

Some fundamental questions about the proper purpose and function of a proxy model must be resolved. The Commission should clarify what the Recommendation means (§ 270) when it speaks of modeling “the costs that would be incurred by an efficient competitor entering the market.” The statutory acceptance (or prescription in non-rural high cost areas) for more than one supported carrier in high cost areas assumes away the economic indications of a natural monopoly situation in the existence of costs high enough that market conditions alone would not achieve optimal subscribership and network development. It is not clear to TDS and Century, for example, how a forward looking proxy should model an optimally efficient competitor network constructing “from the ground up”¹⁵ in a thinly-populated rural area. It appears that there may be an implicit assumption that the second and additional networks will in each case demonstrate the same efficiency as the first. Is there any evidence for that assumption in predicting efficient costs for competitors?¹⁶ Should the model design and price the network components as if there would be only that one efficient network to serve the

¹⁵Kahn letter, supra.

¹⁶For example, cable television operators generally apply a rule of thumb for the number of potential customers that a route must pass per mile to justify construction. Do the proxy inputs reflect the effect on the costs of providing telephone service with the loss of various degrees of market share?

community? If not, how does the hypothetical "efficient competitor" proxy network design reflect that it is not the first or only provider? How many "efficient" competing networks should the cost model assume? Should the model assume traffic will increase to use all "efficient" proxy cost - based networks in an area? Should the costs of the idealized "efficient competitor" network reflect the costs of dividing traffic and customers between or among networks.¹⁷ Is the competitor in the model efficient if the proxy costs exceed the incumbent's actual costs, as Professor Kahn suspects?¹⁸ How will the forward-looking model be kept "forward-looking"? How often will it be revised? How will the support be kept "predictable," let alone "specific" and "sufficient," if the hypothetical model keeps substituting newer, more cost-effective technology, while real life networks are not re-engineered each time new technology is introduced? What discount does the model assume a competitor receives on its network purchases from an incumbent? How do the inputs take into account economies of scale and scope in serving specific areas or for specific providers? How could sufficient support be derived for an RLEC from a model that assumed the discounts AT&T can obtain in buying switches? Alternatively, how can excess support not be derived for AT&T unless its unique ability to command equipment discounts (due to the extent of its purchases from manufacturers) is taken into account? With the inherent uncertainty of a model based on the costs of a

¹⁷John C. Panzar and Steven S. Wildman, Competition in the Local Exchange: Appropriate Policies to Maintain Universal Service in Rural Areas, p. 5, n. 4; see also J. Panzar, The Economics of Telecommunications Infrastructure Enhancement, p. 16 (April 1990).

¹⁸Kahn letter, above ("...there is reason to believe that starting all over from the ground up would be more costly than working from [LECs'] present facilities base.")